

***United States Court of Appeals  
for the Second Circuit***



**BRIEF FOR  
APPELLANT**





76-5007

IN THE  
UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

76 - 5007

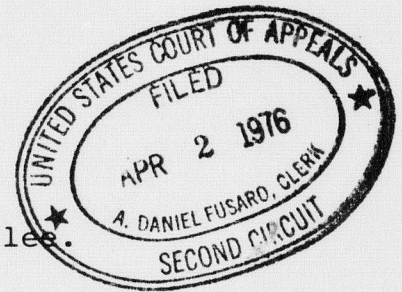
CAMELIA BUILDERS, INC., E.J. YELVERTON, JR.  
FARNALE, INC., R.L. GOODALE and JEFFREY H.  
HUBBARD,

Respondents-Appellants,

versus

FIDELITY MORTGAGE INVESTORS, Debtor,

Applicant-Appellee.



BRIEF FOR APPELLANTS

APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK  
HONORABLE RICHARD OWEN, JUDGE PRESIDING

Jeffrey H. Hubbard  
2297 Two Shell Plaza  
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ATTORNEY FOR APPELLANTS



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OPINION BELOW

The Record contains the memorandum opinion of the United States District Court for the Southern District of New York rendered by the Honorable Richard Owen. It has not been reported yet.

JURISDICTION

Jurisdiction is based upon 28 U.S.C. 1291.



### STATEMENT OF THE CASE

This case involves an Application (Application) to the Bankruptcy Court for the Southern District of New York by Fidelity Mortgage Investors (FMI) operating as Debtor in Possession under Chapter XI of the Bankruptcy Act to hold Camelia Builders, Inc., E.J. Yelverton, Jr., Farnale, Inc., R.L. Goodale, Jeffrey H. Hubbard and Thomas W. Crockett, Jr., (Respondents), guilty of civil contempt by reason of the filing of a lawsuit by Camelia Builders, Inc.-Farnale, Inc., a Joint Venture (Joint Venture) against FMI in the United States District Court for the Southern District of Mississippi (Mississippi Action). Respondents Hubbard and Crockett are legal counsel for Farnale, Inc., Camelia Builders, Inc. and the Joint Venture. R.L. Goodale and E.J. Yelverton, Jr. were officers of the corporate Respondents and the Joint Venture. At time of hearing on the Application, FMI voluntarily dismissed as to Mr. Crockett. The Joint Venture has not been made a part to the proceedings.

The Joint Venture, a Texas entity, was the general contractor for a construction project located in Jackson, Mississippi. Camellia Bay Corporation (Owner), unrelated to Camelia Builders, Inc., was the Owner of the project having a leasehold interest in the real property. FMI was the interim lender of the Owner and the beneficiary of a deed of trust lien on the leasehold estate. The Joint Venture had filed a mechanic's and materialman's lien against the property in 1974 and instituted an action in the Rankin



County Court of Mississippi (State Court Action) in January, 1975 to foreclose the lien. Thereafter FMI filed a petition under Chapter XI on or about January 30, 1975. The Joint Venture instituted the Mississippi Action on March 24, 1975 to protect its lien after FMI caused the trustee of the deed of trust to commence proceedings to foreclose its deed of trust lien by Trustee's sale.

A hearing was held in the Mississippi Action on March 26, 1975 at which time the Court permitted the Trustee's sale to proceed provided the trustee deposit in the registry of the Court from the proceeds of the sale the sum of \$75,964.33 representing the amount of the mechanic's and materialmen's lien of the Joint Venture. The Trustee's sale was conducted on March 28, 1975 and thereafter the trustee did deposit \$75,964.33 in the registry of the Court.

The basis for the Application is an alleged violation of Rule 11-44 of the Chapter XI Rules in that the Respondents, with actual knowledge of the pending Chapter XI proceeding of FMI commenced the Mississippi Action for the alleged purpose of enforcing a lien on the property of FMI.

After Respondents were required to personally appear before the Bankruptcy Court and show cause pursuant to Rule 920 of the Bankruptcy Rules why they should not be adjudged guilty of civil contempt by reason of the alleged violation of Rule 11-44 of the Chapter XI Rules,



the Bankruptcy Court determined in its Decision of Proceeding to Certify for Contempt (Decision) Respondents were guilty of civil contempt, concluded that their conduct should result in more than the limited punishment permissible under Rule 920 and certified the matter to the United States District Court by issuing an Order to Show Cause Why Respondents Should Not be Adjudged Guilty of Civil Contempt (Show Cause Order) requiring Respondents to personally appear before the said District Court.

At time of hearing on the Show Cause Order, FMI offered in evidence the Certificate of Facts Showing Contempt of the Bankruptcy Court and rested and Respondents motioned for a directed verdict. The District Court ruled that the proceeding was an appeal, denied the motion to dismiss and in an Order Under Bankruptcy Rule 920(a)(4) Adjudging Respondents Guilty of Civil Contempt (Judgment) found Respondents guilty of civil contempt, ordered that Respondents take all appropriate action to effectuate the return of \$75,694.33 deposited by FMI in the registry of the Court in the Mississippi Action and assessed as costs all attorney's fees of FMI against Respondents jointly and severally. Respondents appealed from the Judgment having obtained an order of the District Court staying the enforcement of same.



## ARGUMENT

### I.

The Courts Below Are Without Jurisdiction  
To Adjudicate Civil Contempt Based Upon A  
Violation Of A Rule 11-44 Of The Chapter XI Rules  
And Consequently The Application Of Certificate  
Of Facts Fail To State A Cause Of Action

The Application and Show Cause Order were brought  
pursuant to Rule 920 of the Bankruptcy Rules which provides  
in part:

"(2)...Any other conduct prohibited by § 41(a)  
of the Act may be punished by the referee only  
after hearing on notice...."

(4)...If it appears to a referee that conduct  
prohibited by § 41(a) of the Act may warrant  
punishment by imprisonment or fine of more than  
\$250 he may certify the facts to the district  
judge. On such certification the judge shall  
proceed as for contempt not committed in his  
presence."

The conduct described in § 41(a) (11 U.S.C. 69)  
includes in part:

"disobey or resist any lawful order, process,  
or writ...."

The language contained in 11 U.S.C. 69 is in contrast  
to the language relating to the contempt power of a District  
Court as contained in 18 U.S.C. 401 which provides in part:

"(3) Disobedience or resistance to its lawful  
writ, process, order, rule, decree or command."  
(emphasis added)

Respondents are adjudged guilty of civil contempt  
pursuant to 11 U.S.C. 69 for their alleged violation of  
Rule 11-44 of the Chapter XI Rules which provides in part:



"A petition...shall operate as a stay of the commencement or continuation of any court...proceeding...or proceeding to enforce any lien...."

The Bankruptcy Rules, like the Federal Rules of Civil Procedure, have been promulgated by the Supreme Court of the United States pursuant to 28 U.S.C. 2507 which statute provides in part:

"Such rules shall not abridge, enlarge or modify any substantive right...."

Bankruptcy Rule 928 provides:

"These rules shall not be construed to extend or limit jurisdiction of courts of bankruptcy over subject matter."

It appears to follow that the Bankruptcy Rules cannot give rise to a substantive right that did not therefore exist; a right in a debtor to recover costs and require the turn over of property pursuant to 11 U.S.C. 69 for a violation of a Bankruptcy Rule.

In this regard, please note that Bankruptcy Rule 114 relating to appearance of the alleged bankrupt in involuntary proceedings provides that non-compliance therewith may result in the imposition of sanctions specified in Paragraphs (A), (B) and (C) of Rule 37(b)(2) of the Federal Rules of Civil Procedure and thus carefully omits the sanctions of contempt. Rule 45 of the Federal Rules of Civil Procedure provides that a violation thereof may be punished by contempt. Bankruptcy Rule 208 provides in the case a violation relating to the solicitation of proxies



that the Court may take appropriate action without defining same. A similar provision is found in Bankruptcy Rule 219 which contains provisions relating to compensation. Bankruptcy Rule 770 provides that where a person fails to abide by a judgment directing him to deliver a document or perform an act he may be held in contempt pursuant to Rule 920.

Rule 11-44 provides for no sanctions of any nature for violation thereof.

It has long been the law that the Supreme Court and all courts created by Act of Congress could prescribe rules for the conduct of their business provided the same are consistent with Acts of Congress. 29 U.S.C. 2071. Rules so promulgated have the force and effect of an order and thus courts may impose sanctions for violations of rules. Link v. Wabash Ry. Co., 291 F.2d 542 (7th Cir. 1961) affirmed, 370 U.S. 626, 82 S.Ct. 1386, 8 L.Ed.2d 734, rehearing denied, 371 U.S. 873, 83 S.Ct. 115, 9 L.Ed.2d 112, but the power of contempt in the courts of bankruptcy is restricted in comparison to the contempt power vested in the district courts. 11 U.S.C. 69; 18 U.S.C. 401.

It is interesting to note that the Supreme Court in providing for the sanction of contempt in the Bankruptcy Rules and the Federal Rules of Civil Procedure limits same to instances where there is a prior order of the court (Rule 37 F.R.C.P. and Rule 770 of the Bankruptcy Rules) or



the issuance of a process under seal of the court (Rule 45, F.R.C.P.). In no case does the Supreme Court suggest that disobedience of a rule in and of itself may constitute contempt of court.

Thus it is clear that while a District Court sitting as such has available to it by reason of 18 U.S.C. 401 the sanction of contempt for a violation of its rules, the jurisdiction of a court of bankruptcy including a District Court when so sitting to impose the sanction of contempt or the power of the Bankruptcy Court to certify a contempt proceeding to the District Court is clearly limited to violations of orders, writs and processes and does not include rules. 11 U.S.C. 69. In Re: Schwartz, 14 F. 787 (D.C. N.Y. 1882); Magen v. Campbell, 186 F. 675 (3rd Cir. 1911) This clear rule of law was announced in 1923 in construing 11 U.S.C. 69 in the following language:

"The jurisdiction of the referee to issue such a certificate is granted and limited by that section which provided that the referee may make the certificate 'if any person shall do any of the things forbidden in this section.' Obviously he has no jurisdiction if any person shall do anything not forbidden by that section."  
Wakefield v. Housel, 288 F. 712 at 717 (8th Cir. 1923)

11 U.S.C. 69 has been amended by Congress since the decisions in Schwartz, Magen and Wakefield but same in no way affected the decision or sought to expand the limited jurisdictional grant contained in the statute with the result that the only reasonable conclusion to be drawn is that holding of Schwartz, Magen and Wakefield have been approved by Congress.



## II.

### The District Court Erred in Adjudging Respondents Guilty of Contempt As The Meaning of Rule 11-44 Is Obscure

As aforesaid, the basis for the instant proceeding is an alleged violation of Rule 11-44 of the Chapter XI Rules. Prior to the enactment of Rule 11-44 it was clear that this Court had authority in a Chapter XI proceeding to stay the commencement or continuation of suits; an example of such an order was contained in 10 Collier, Bankruptcy, p. 1104, Form 3501 which provides in part: "...all persons be..enjoined...from commencing...any suit..." (Emphasis added).

As originally drafted (The Committee on Rules of Practice and Procedure of the Judicial Conference of the United States, Preliminary Draft of Proposed Bankruptcy Rules and Official Forms under Chapter XI of the Bankruptcy Act which was published by the U.S. Government Printing Office in Washington, D.C., October 1972) Rule 11-44 provided in part as set forth on page 56 of said publication that a petition filed "...shall operate as a stay of the commencement or continuation of any action against the Debtor." (Emphasis added). Said language is similar to the language used in Rule 401 and Rule 13-401 of the Bankruptcy Rules. After the original draft, Rule 11-44 was changed to provide only "...any court or other proceeding..." (Emphasis added) as opposed to "suits" or "actions." Apparently, the only other language contained in the Bankruptcy



Rules pertaining to automatic stays is contained in Rule 601 which provides in part "...any court proceeding...or other legal or equitable processes or proceedings."

(Rule 10-601, containing language similar to Rule 11-44, has been promulgated subsequent to the occurrence of all events involved herein).

In this connection, whereas Rule 13-401 is to be given the broadest possible meaning, it does not use the word "court"; neither does Rule 401 use the word "court." The word "court" is a word of art as used in Bankruptcy law for the reason that same is defined in 11 U.S.C. 1(9) to mean the judge or referee of the Court of Bankruptcy in which the proceedings are pending. It is clear from the history of Rule 11-44 aforesaid that the word "court" has been purposefully substituted for the word "action" and that the phrase "or other legal or equitable processes or proceedings" has similarly been purposefully deleted from said rule. Obviously then, Rule 11-44 relates to conduct that is different from that contemplated by Rules 401, 601 or 13-401 and thus leaves said conduct undefined. Civil contempt does not lie for a violation of an order of court unless the order is clear and decisive and contains no doubt about what it requires to be done. N.L.R.B. v. Deena Artware, Inc., 261 F.2d 503 (6th Cir. 1958), rev'd on other grounds, 361 U.S. 398, 80 S.Ct. 441, 4 L.Ed.2d 400 (1960).



As to the question of lien enforcement please note that the lien protected by the Joint Venture in the Mississippi Action was a lien against property of the Owner, not FMI. (25, 39)

As was noted by the Court in reversing a conviction of contempt of driver salesmen for interfering with "routes" that were found by the District Court to be the property of a debtor in Chapter XI:

"...the order which is said to have been violated must be specific and definite."  
In Re: Rubin, 378 F.2d 104, 108 (3rd Cir. 1967).

As it has been held that the Bankruptcy Court has no jurisdiction to enjoin:

(1) a lienholder from instituting suit against the owner of the property and naming the bankrupt who also held a lien against said property in the suit;  
In Re: A. Roth Co., 125 F.2d 396 (7th Cir. 1942) (discussed in Point VII, page 22 of this brief);

(2) a claimant who has previously instituted suit in state court to determine the rights of a party in real estate; Town of Agawam v. Connors, 159 F.2d 360 (1st Cir. 1947), cert. denied, 330 U.S. 845, 67 S.Ct. 1806 91 L.Ed. 1290 (1947), (discussed in Point VII, page 22 of this brief), and;

(3) Rule 11-44 is inapplicable to a lawsuit that will not affect any property subject to the jurisdiction of



the Bankruptcy Court, Mid Jersey National Bank v. Fidelity Mortgage Investors, 518 F.2d 640 (3rd Cir. 1975), (discussed in Point VIII, page 25 of this brief); and that Rule 11-44 shall not extend jurisdiction of courts of bankruptcy (discussed in Argument I, page 5), it does appear that it cannot be said that Rule 11-44 can leave no doubt that the Mississippi Action would be a violation of the stay contemplated therein.



III.

The District Court Erred In Concluding That  
The Certificate Of Facts Of The Bankruptcy  
Court Must Be Accepted Unless Clearly  
Erroneous And In Failing To Dismiss Or Abate  
For Want Of Evidence Or Insufficient Evidence

At time of hearing herein before the District Court  
on August 19, 1975 FMI offered into evidence the Certificate  
of Facts Showing Contempt made by the Bankruptcy Judge and  
rested its case. (Respondents' Statement Where No Report Was Made)  
In response thereto, Respondents motioned for directed  
verdict on the grounds that there was no evidence of contempt  
as the Certificate of the referee constitutes at most a mere  
pleading and the prosecution has the burden of proving  
contempt where a certificate is answered by pleading not  
guilty. In Re: McIntosh, 73 F.2d 908 (9th Cir. 1934). The  
District Court relies upon Bankruptcy Rule 810, which Rule  
provides in part:

"Upon an appeal the district court may affirm,  
modify or reverse a referee's judgment or order  
or removal with instructions for further  
proceedings. The court shall accept the  
referee's findings of fact unless they are  
clearly erroneous...."

for its authority that it must accept the referee's findings  
of fact unless they are clearly erroneous and concludes said  
Certificate is evidence and not clearly erroneous. (20, 21)

In the instant case there is neither a judgment nor  
order of the referee nor is there an appeal. The clearly  
erroneous rule has no application to a certificate of facts  
in contempt as the certificate is merely the means of



informing the District Court of the alleged contempt and is not binding nor does it conclude the District Court's action in any manner. O'Hagan v. Blythe, 354 F.2d 83 (2nd Cir. 1965). In the instant case, as the authority to punish rests in the hands of the District Court, the District Court in considering the issue must exercise its sole independent judgment in deciding facts and reaching conclusions and consequently the rule announced in O'Hagan v. Blythe, supra, remains applicable in the instant case. In this connection, there appears to be no matter in the Bankruptcy Rules which purports to change 11 U.S.C. 69(b) which provides in part upon certificate that:

"The judge shall thereupon, in a summary manner, hear the evidence...."

and same is reinforced by the provisions of Bankruptcy Rule 920 which provides in the case of certification:

"(4)...the judge shall proceed as for a contempt not committed in his presence."

The referee's findings are to "...be subject to a wholly independent judicial review." In Re: Rubin, 378 F.2d 104, 108 (3rd Cir. 1967). It follows that there was no evidence or insufficient evidence before the District Court to adjudge Respondents in contempt.



IV.

The Findings Of The Bankruptcy Court And  
The District Court Are Clearly Erroneous  
And There Is No Evidence Or Insufficient  
Evidence To Support The Same.

Both Courts below have concluded:

1. That Respondents sought an order in the Mississippi Action enjoining FMI from conducting a non judicial sale (11,20,89) while the Complaint in the Mississippi Action demonstrates that the Joint Venture sought an order to show cause pertaining to its lien rights or in the alternative funds held in trust by FMI for the benefit of the Joint Venture (32A, 82A, 110,111).The only injunction sought pertained to final relief and was limited to "...the property and improvements that are the basis of this lawsuit...." i.e., the mechanic's and materialman's lien or trust funds in the amount of \$75.964.33 (112).

2. That Respondent knew of FMI's Chapter XI proceeding on the day the Mississippi Action was filed based upon his own testimony (21). While there is testimony that a cause number for the Chapter XI was obtained after filing the Mississippi Action (18) it was coupled with the advice of the office of the Bankruptcy Court in New York to the effect that: "There are no other papers other than the petition, there are no orders on file in this cause". (18, 79A)



3. That relief was available under Rule 11-44(e) (21) yet the only evidence is that because of the press of time and doubt as to whether or not FMI was in Chapter XI it was not logistically possible to travel to New York and still have time to return to Mississippi if there was no Chapter XI (327) and same has been asserted by Respondents without denial thereof by FMI in the briefs (77).

4. The conclusion of the Bankruptcy Court that reliance upon 28 U.S.C. 959 was an afterthought brought to light after the event for the purpose of justifying the violation of Rule 11-44 (92) when the Complaint filed in the Mississippi Action states on Page 2 in Count 1: "...bring this cause of action pursuant to 28 U.S.C. 959." (109)

5. That the Mississippi Action sought to enforce a pre-petition indebtedness (95) when the debt is owing by the Owner to the Joint Venture and is secured by a mechanic's and materialmen's lien.

In addition to the advise that no order had been entered, there were other suspicious circumstances pertaining to the Chapter XI proceeding in New York, including:

- (a) FMI at all times material hereto was known by Respondents to have its principal place of business in Jacksonville, Florida. (1, 43, 44, 68 and 69) Bankruptcy Rule 116) In Fact, on or about September 1975 FMI filed a Stipulation of Fact in FMI v. Camelia Bay Corporation, et al, In the Circuit Court of The First Judicial District of Hinds County, Mississippi, Cause No. 22,870 stating that the principal business office of FMI is Jacksonville, Florida, a true and correct copy of said Stipulation



is attached to this brief as Exhibit "A".

- (b) Respondents received no formal notice of the proceedings from either FMI or the Bankruptcy Court. (45, 46, 59, 60, 70, 74)
- (c) The only notice of any nature received was a newspaper article and an unverified plea in abatement filed in a state court proceeding which alleged the Chapter XI but failed to give a cause number for the said arrangement proceedings and contained no exhibits. (126, 140)
- (d) That the lawyer who filed the aforesaid plea in abatement had previously filed mechanics and materialmen's liens on behalf of subcontractors of the Joint Venture and was co-partner in the law firm conducting the foreclosure with the result that he was contending for competing lien rights. (14, 15, 37)
- (e) No effort was made by FMI to apprise Respondents of the Chapter XI after the filing of the Mississippi Action until the conclusion of the evidence in the hearing had in the Mississippi Action (41) through FMI did have time to prepare and gather evidence to defend on the merits as demonstrated by two affidavits dated March 26, 1975 entered in the Mississippi Action by FMI (50)
- (f) That a copy of the petition under Chapter XI had not been recorded in Rankin County, Mississippi. Bankruptcy Rule 602 (16, 17)

6. That the property interest of FMI in connection with the deed of trust is in custodia legis with the Bankruptcy Court when in fact all matters in connection therewith were in the State Court of Rankin County, Mississippi at the time of filing of the Chapter XI. (45, 124)

In the event the Bankruptcy Court elects to disbelieve all of the testimony of Respondents herein still



the only affirmative admissible evidence of knowledge of the Chapter XI proceedings consists of an unsworn pleading filed in a state court without exhibits alleging the Chapter XI proceeding but failing to give the cause number of same, and an approximate four line article in the Wall Street Journal making reference to a Fidelity Mortgage filing bankruptcy in New York which evidence is insufficient as a matter of law to charge knowledge of the Chapter XI proceeding, for knowledge within the meaning of the law, consists of credible information on material facts. Sackett v. Farmer's State Bank of Boone, 228 N.W. 51 (Iowa 1929).

Of course, knowledge is an indispensable element of contempt, In Re: Rubin, supra. It does appear that to charge an attorney whose duty is to contend for the rights of his client to \$75 .33 with knowledge of the Chapter XI based upon the facts of this case would establish an onerous burden upon all advocates and may have the effect on creditors in the future of denying to clients their right to counsel.



V.

Respondents Have Been Denied Due  
Process of Law Because Of The  
Irregularities In The Proceedings.

In its Application FMI prayed:

"that the Court adjudge Respondents in contempt of its lawful order, or, in the alternative, that the Court certify to the District Judge the facts of Respondents' contemptuous conduct and enter an order directing Respondents to appear before the District Judge to show cause...." (105 - 106)

In response thereto the Bankruptcy Court issued its Order directing all Respondents:

"to show cause before me in room 234...why they should not be adjudged guilty of civil contempt...." (103)

At the time of hearing before the Bankruptcy Court FMI announced:

"...this is a contempt brought on pursuant to an order to show cause...." (24A)

Thus it is clear that FMI and the Bankruptcy Court had elected to proceed with the contempt in the Bankruptcy Court rather than certifying the matter to the District Court. There is no provision in either Rule 920 or 11 U.S.C. 69 that contemplates the Bankruptcy Court first conducting an inquiry by requiring Respondents to appear and show cause and then certifying the matter to the District Court. To the contrary, Rule 920 provides in part:

"(2) Any other conduct prohibited by § 41a of the Act may be punished by the referee only after hearing on notice.

(4) If it appears to a referee that conduct prohibited by § 41a of the Act may warrant punishment by imprisonment or fine of more than \$250, he may certify the facts to the District Judge."



Yet Respondents were again required to appear before the District Court to show cause why they should not be adjudged in contempt. (6)

While the rules implicitly contemplate a method of apprising the referee of the alleged conduct, that hearing has been conducted ex parte on the Application. (102, 103)

Thus if the referee takes jurisdiction of the matter he may proceed to hearing. If, on the other hand, the Application indicates the conduct is more serious than the limits of his jurisdiction enable him to effectively deal with, he certifies the matter to the District Court. The procedure is: "mandatory and must be followed to the letter." 2 Collier, Bankruptcy ¶ 41.09, pg. 1596 (14th Ed. 1962) and the failure to strictly follow same is fatal.

In Re: Gitkin, 164 F. 71 (E.D.Pa. 1908), In Re: McIntosh, 75 F.2d 908 (9th Cir. 1934).

Additionally, Respondents have been ordered to effectuate the return of \$75,964.33 which will void the lien rights of the Joint Venture (see discussion, Argument IX) without hearing thereon (In Re: Rubin, supra, Maggio v. Zeitz, 333 U.S. 56, 92 L.Ed. 476 (1947), to the effect that a contempt proceeding is not to be used to determine if Respondents have interfered with property rights of FMI within the jurisdiction of the Bankruptcy Court) despite the findings of the Court in the Mississippi Action to the effect that:

"...under the circumstances and due to the exigency of the situation, to deny the Plaintiff the right to proceed at this time would be denying him his day in court to a moot question..." (128) and,

without regard to the rights of the Joint Venture under the 5th Amendment of the United States Constitution.



VI.

FMI By Its Failure to Notify Respondents  
Of The Chapter XI Proceedings Has Waived  
Its Right to Stay Respondents

That FMI was fully aware of the Joint Venture and its mechanic's and materialmen's lien at the time of filing of the Chapter XI on January 30, 1975 proceeding is conclusively demonstrated by the existence of the State Court proceeding brought to enforce the lien of the Joint Venture and in which FMI had been served prior to January 30, 1976. (27, 33, 68)

The only effort made by FMI until the conclusion of the evidence in the Mississippi Action to notify the Joint Venture of the Chapter XI proceeding was the filing of an unsworn plea in the State Court lawsuit which contained no exhibits and omitted the cause number of the Chapter XI proceeding. (126)

In regard to the failure of FMI to file a certified copy of its petition for Chapter XI with the Clerk in Rankin County, Mississippi (16, 17) as required by Bankruptcy Rule 602(a) or furnish a cause number in the plea in abatement as required by Bankruptcy Rule 602(b) it has been said:

"But in denying this motion as to them, I prefer to place my decision upon the broader ground that those who procure an ex parte injunction, and make no efforts to serve it upon the persons who they claim shall be bound by it, though they are easily accessible, are not entitled to proceed for contempt upon any accidental, doubtful, and disputed notice of the injunction alleged to have been conveyed indirectly only through other persons. Parties designed to be bound by an injunction have a right to expect service in



the ordinary way, if they are accessible; and if they are not so served, and no excuse for it appear, as to them the injunction should be deemed waived or as never in force."

In Re: Cary, 10 F. 622 (S.D.N.Y. 1882)

In this regard, while the Bankruptcy Court takes Respondents to task for not contacting FMI to determine if they have invoked the protection of the Bankruptcy Act (73) it is a puzzlement to Respondents why they were not contacted by FMI. In this connection, while much was made of the fact that the office of FMI's counsel in Mississippi is located in the same town and perhaps the same building as is the office of Mr. Crockett, it is also true that Mr. Crockett's office is located in the same town and perhaps the same building as is the office of FMI's counsel in Mississippi.(80 - 81)



VII.

Because Of The Prior State Court Action The  
Bankruptcy Court Does Not Have Jurisdiction  
Of The Rights Of FMI In The Deed Of Trust

The rationale for staying a deed of trust lienholder from foreclosing where title to the property is in the debtor is that such a lienholder takes subject to the contingency that proceedings in bankruptcy against his mortgagor may deprive him of the specific remedy contemplated in his contract. 1 Collier, Bankruptcy, ¶ 2.62 (2), pg. 336 (14th Ed. 1968). But can it be said a contractor contemplates a similar stay where his security for payment and method of enforcement is provided for by State law?

The instant case is further distinguishable in that at all times material the Joint Venture and FMI are both lienholders and the title to the property is in the Owner. As was stated by Judge Minton in In Re: A. Roth Co., Inc., 125 F.2d 396, 398 (7th Cir. 1942):

"I have never understood that A, wanting to foreclose a mortgage on property owned by B had to get consent of a bankruptcy court to foreclose that mortgage, or to make a trustee in bankruptcy a party, simply because C. the bankrupt, also had a mortgage on B's property."

In the case of Town of Agawam v. Connors, 159 F.2d 360 (1st Cir. 1947), cert. denied, 330 U.S. 845, 67 S.Ct. 1806, 91 L.Ed. 1290 (1947) where the City had brought suit to foreclose a right of redemption and thereafter bankruptcy proceedings were commenced the Court held a right of redemption is a transferable interest in land which vested in



the Trustee in bankruptcy but that the Trustee acquired an interest no larger than that of the bankrupt, i.e. a property interest subject to the prior jurisdiction of the Land Court as suit affecting the redemption was filed in the Land Court prior to the filing of the bankruptcy. The Court states at page 364 of its opinion:

"It is not less subject to the jurisdiction of the Land Court because the bankrupt continued in possession."

and concluded that the bankruptcy court lacked authority to issue a restraining order as to the Land Court suit.

FMI as debtor in possession has no greater property rights than it would have but for the Chapter XI proceeding. In Perry v. Wood, 63 F.2d 257 (5th Cir. 1933) where subcontractors filed liens against a project for non-payment of their contracts and an involuntary petition in bankruptcy was filed against the general contractor after the owner tendered the balance due to the general contractor, which was less than the total of the lien claims, into the registry of the state court where the suit on the subcontractors' liens was pending, there was no money or fund so deposited to which the trustee in bankruptcy had any title or interest.

In the instant case, all issues pertaining to the rights of FMI as a result of the deed of trust are subject to the prior jurisdiction of the State Court in Rankin County, Mississippi, FMI having been served therein on January 28, 1975, and therefore Respondents could not have interfered with any property rights in custodia legis of the Bankruptcy Court. (26, 33, 68, 121) In Re: Grissler, 136 F. 754 (2nd Cir. 1905).



VIII.

The Stay Provided In Rule 11-44  
Chapter XI Rules is not Applicable to Respondents  
As the Mississippi Action Cannot Affect the Plan of FMI.

In the State Court Action the Joint Venture as  
Plaintiffs sought in addition to other relief:

"B. That Plaintiff's be adjudged to have a lien on  
said property securing said sum (\$75,964.33);

C. That said judgment be executed and the property  
sold as provided by Section 85-7-151, Mississippi  
Code 1972, Annotated, and other appropriate statu-  
tory provisions; and

D. That the lien of Plaintiffs be adjudged to be  
superior to that of Defendant Fidelity Mortgage  
Investors. " (124)

Clearly then, the Bankruptcy Court did not acquire jurisdiction  
of the rights of FMI arising from the deed of trust in  
issue. See discussion of Point VII and cases cited therein.

As to the question of whether the mere naming of  
FMI in the Mississippi Action was a violation of Rule 11-44  
it is to be recalled that the real party in interest was the  
Trustee of the deed of trust, Mr. James L. Young, (25, 139)  
as he alone had the power to conduct the sale. Baker v.  
Connecticut General Life Ins. Co., infra. The \$75,964.33  
in issue was never in the possession of FMI as it was paid  
by the Trustee directly to the registry of the federal  
court in Mississippi (17) pursuant to order of the federal  
court addressed to Trustee Young. (139)

Neither the Bankruptcy Court nor the District Court  
found that the Mississippi action embarrassed the estate of FMI



nor interfered with the execution of its plan of arrangement. In Mid Jersey National Bank v. Fidelity Mortgage Investors, 518 F.2d 640 (3rd Cir. 1975) FMI sought to stay the litigation then in progress by invoking the provisions of Rule 11-44. The Court addresses the issue by first noting that the purpose of Rule 11-44 is to prevent interference with or diminution of the debtor's property during the pendency of the arrangement proceeding or to prevent a creditor from defeating jurisdiction of the Bankruptcy Court over the debtor's property by institution of suit in another court. The Court then considers the question posed by a \$300,000 certificate of deposit FMI had posted with the registry of the Court in lieu of a supersedeas bond and concludes on a trust fund theory that the Bankruptcy Court had no jurisdiction over the certificate of deposit. As to the issue of the maintenance of the lawsuit itself, the Court quotes with approval the following statement of Judge L. Hand in In Re: Commonwealth Bond Corp., 77 F.2d 308, 309 (2nd Cir. 1935):

"Stays must be ancillary to the main purpose of the proceeding and are not lawful when they cannot contribute to execution of the plan."  
(emphasis added)

The Court then concludes that as the Bankruptcy Court has no jurisdiction over the certificate of deposit, the lawsuit could not affect the plan and therefore Rule 11-44 was not applicable.



In the instant case, the Bankruptcy Court did not acquire jurisdiction of the rights of FMI in the deed of trust or to the \$75,964.33 in issue as jurisdiction was in the State Court action prior to the institution of the Chapter XI proceeding by FMI. (33) Town of Agawam v. Connors, supra. It appears to follow that the Mississippi Action cannot affect the plan of FMI and consequently Rule 11-44 is inapplicable thereto or not lawful. In Re: Commonwealth Bond Corp., supra.



IX.

The Rule 11-44 Stay is Inapplicable to Respondents  
By Reason of FMI Instituting a Foreclosure Proceeding  
Which Would Alter the Status Quo

At the time of institution of the Mississippi Action, the Joint Venture held a mechanic's and materialmen's lien and FMI was the beneficiary of a deed of trust lien against a leasehold estate in property, the legal title of which was in the Owner who was then in possession.

The right of FMI as beneficiary of the deed of trust is only to cause the trustee thereof to sell the property and apply the proceeds secured by the deed of trust to the debt owing; FMI has no interest in the real estate. Baker v. Conn. General Life Ins. Co., 18 So. 2d 438 (Miss. 1944) and the Bankruptcy Court did not have constructive possession thereof, Town of Agawam v. Connors, supra, and all rights of FMI arising under the deed of trust in relation to the Joint Venture were already in issue in the State Court action. 4 Collier, Bankruptcy, ¶ 67.22, pp. 267-272 (14th Ed. 1967)

Please recall that while the mechanic's and materialmen's lien for \$75,694.33 arises from non payment by the Owner, FMI did not advance said sum to the Owner; that is the lien is for work for which FMI did not advance funds. (136, 137) In this connection, the Supreme Court of Mississippi has held in the case of a deed of trust where the lender was irrevocably bound to make advances and it was the parties expressed intention that the deed of trust be paramount, that still the



mechanic's and materialmen's lien is given priority except to the extent that money secured by the deed of trust was actually used in paying for construction. Weiss, Dreyfous & Seiforth v. Natchez Inv. Co., 140 So. 736 (Miss. Div. A 1932) As the need to protect the priority of the deed of trust where the lender is irrevocably bound to advance funds appears to be more compelling than where the lender is not so bound it does clearly appear that in Mississippi the mechanic's and materialmen's lien of the Joint Venture is superior to the deed of trust lien of which FMI is beneficiary, but it is clear under Mississippi law that the failure of the Joint Venture to protect its lien rights will result in their loss. First National Bank of Greenville v. Virden, 45 So.2d 268, 271 (S.Ct. Miss. en banc 1950)

While there is no case directly in point, the lien statutes of Mississippi are not unlike those of Texas where the state Supreme Court has held that as to movables installed within a building, the mechanic's and materialmen's lien rights are superior to a deed of trust lien. First National Bank in Dallas v. Whirlpool Corp., 517 S.W.2d 262 (Tex. 1975)

The lien of the Joint Venture arises pursuant to § 85-7-101 and § 85-7-131 of the Mississippi Code of 1972 providing the contractor with a lien on the buildings constructed and the movables therein installed by the contractor such as kitchen cabinets, garbage disposals, stoves, plumbing fixtures, etc. Buckwalter v. Beeker's Welding & Machinery Co., 189 So. 526



(S.Ct. Miss. Div. B 1939) to the effect that where Owner of property declared bankruptcy property passed to Trustee subject to mechanic's and materialmen's lien.

Of course, the mechanic's and materialmen's lien may be valid against a Trust or Debtor-in-Possession 11 U.S.C. 107(b) and is not a preference 11 U.S.C. 96 but pursuant to § 85-7-105 Mississippi Code of 1972, the lien as to movables exists only while the property is in possession of the Owner or one deriving title through the owner. As stated in Buckwalter v. Beeker's Welding, supra, at page 530:

"The lien was retained...and enforceable while the property remained in the hands of the then owner, Myles Gravel Co., or while in the hands of one deriving title or possession through said gravel company with notice that the indebtedness represented by the mechanic's lien was unpaid."

Once FMI caused the trustee of the deed of trust to commence non judicial foreclosure, the Joint Venture was presented with the prospect of a new owner deriving its title through the Trustee of the deed of trust which would have the effect of voiding the mechanic's and materialmen's lien. Under Mississippi practice such a foreclosure is an invitation to petition a court for an order to show cause why the trustee should not be required to conduct a judicial foreclosure otherwise the mechanic's and materialmen's lien is cut off. As Mr. James Young, Mississippi counsel for FMI in referring to the State Court action, stated:



"Under the statutes made by the State of Mississippi, the complainants in that case have a right to seek to enjoin the foreclosure sale under Mississippi law by posting the proper bond and making the proper showing had they chosen so to do, and they had not chosen so to do, and we were not therefore under restriction and I commenced the foreclosure sale."  
(33)

Thus at all times material hereto title and possession of the property was in the Owner with FMI having only a right to cause the sale thereof which right was in the jurisdiction of the State Court action, Town of Agawam v. Connors, supra, and FMI attempting to alter the status quo by effecting transfer of title and possession and thus cutting off the mechanic's and materialmen's lien of the Joint Venture.

As FMI had neither ownership nor possession of the real property the Bankruptcy Court does not have summary jurisdiction and the controversy is one at law which must be decided in a plenary suit in Mississippi. Taylor v. Carryl, 61 U.S. (20 How.) 588 (1858) Matter of Weston, 68 F.2d 913 (2nd Cir. 1934).

As the purpose of the Mississippi Action was to continue and preserve the mechanics and materialmen's lien of the Joint Venture and as the Bankruptcy Court is without jurisdiction to stay conduct necessary to preserve and continue a mechanic's and materialmen's lien, In Re: Willax, 93 F.2d 293 (2nd Cir. 1937) it follows the stay of Rule 11-44 is inapplicable.



X.

The District Court Erred in Concluding That A  
Lender (FMI) In The Business of Making Loans Secured  
By Deeds of Trust Is Not Carrying On Its Business  
When It Forecloses On a Deed of Trust.

On behalf of the Joint Venture and in response to  
the proposed trustee's sale, Respondent Hubbard caused to  
be filed on March 24, 1975 the Mississippi Action containing  
alternate pleadings depending on whether or not FMI was  
in Chapter XI proceedings including a cause of action  
pursuant to 28 U.S.C. 959 (108 - 112).

The Bankruptcy Court concluded that 28 U.S.C. 959  
is applicable only to suits related to "carrying on the  
business" connected with property entrusted to a Debtor and  
did not encompass the act of a lender in foreclosing on  
security to recover a defaulted loan.

The Statute (28 U.S.C. 959) actually provides:

"(a) Trustees, receivers or managers of any  
property, including debtors in possession, may  
be sued, without leave of the court appointing  
them, with respect to any of their acts or  
transactions in carrying on business connected  
with such property. Such actions shall be subject  
to the general equity power of such court so far  
as the same may be necessary to the ends of  
justice, but this shall not deprive a litigant  
of his right to trial by jury.

(b) A trustee, receiver or manager appointed in  
any cause pending in any court of the United  
States, including a debtor in possession, shall  
manage and operate the property in his possession  
as such trustee, receiver or manager according to  
the requirements of the valid laws of the State  
in which such property is situated, in the same



manner that the owner or possessor thereof would be bound to do if in possession thereof."

Respondents contend that the Mississippi Action is directed towards the manner in which FMI is carrying on business connected with property and apparently FMI is of a like opinion for it alleged in its Application that its "ability to continue operating" was being impaired (104) and it did not obtain prior consent of the Bankruptcy Court to foreclose its lien in Mississippi or cause to be given the required notices of "any proposed sale of property, other than in the ordinary course of business..." Rule 11-24(2) of the Chapter XI Rules; the deed of trust foreclosure being a sale of property under Mississippi law and the notice provision contained in Bankruptcy Rule 11-24(2) not limited to property of the debtor (96). See Bankruptcy Rule 11-23. In this connection, it does appear that foreclosure of a lien by a real estate business trust (1) engaged in the business of making short term construction development loans and ownership and attendant operations of real property (4) would be an act in carrying on business connected with the property particularly where it purchases the property at the sale for its own account and proceeds to operate it as in the instant case. See In Re: Duke, 15 F.2d 92 (E.D.Mo. 1924) to the effect that the business of a bankrupt is conducted when he carries on at least substantially the usual, customary and normal activities of the bankrupt. Of course, if FMI were only in the process of liquidating



the estate, then other serious questions would be raised concerning the propriety of the Chapter XI proceedings as such a proceeding does not contemplate liquidation, but FMI testified before the Bankruptcy Court that it was in the process of foreclosing prior to the filing of the Chapter XI petition and such filing had no effect on the foreclosure. (25, 24, 31, 32)

The Bankruptcy Court has relied upon three cases for the proposition that the foreclosure in Mississippi is not an act of carrying on business within the purview of Section 959:

(1) In Re: American Associated Systems, Inc., 373 F.Supp 977 (E.D.Ky. 1974) is a straight bankruptcy case in which the trustee and referee were sued for conspiracy to defraud and the decision is predicated upon the duty of the trustee to collect and reduce to money all the property of the estate pursuant to Section 47(a) of the Bankruptcy Act. The Court opines that the purpose of Section 959 is to permit actions redressing torts committed in furtherance of bankruptcy business operations. (emphasis added) Please note in the Mississippi Action the Joint Venture complained of the tort of FMI visited upon the Joint Venture in failing to give proper notice of the sale.(110,129) Of course, as title to the property was in Owner and FMI had a beneficial interest in a deed of trust lien against the property, the Bankruptcy



Court had no jurisdiction to stay foreclosure proceedings by the Joint Venture. Brunn v. Wichser, 75 F.2d 25 (3rd Cir. 1934) In a remarkably similar situation to the instant case, where the debtor held a mortgage lien, the Court held there was no jurisdiction to stay the enforcement of other liens against the property. In Re: Copper Canyon Mining Co., 156 F.Supp. 535 (D.Del. 1957).

(2) Austrian v. Williams, 216 F.2d 278 (2nd Cir. 1954), cert. denied, 348 U.S. 953 (1955) involved a suit against former officers and directors of the debtor for derelictions of their corporate responsibilities brought after obtaining leave of the reorganization Court and the Court held that the bringing of such suit was not carrying on business of the debtor, Central States Electric Corp., which was not in the business of suing its former officers. The Court states at page 285:

"We consequently are not required to reach the question subject to some dispute, of the exact effect of 28 U.S.C. Section 959 on Chapter X proceedings as distinguished from ordinary bankruptcy proceedings." (emphasis added)

(3) American Brake Shoe and Foundry Co., v. Interborough Rapid Transit Corp., 10 F.Supp. 512 (S.D.N.Y. 1935) to the effect that actions directly related to the receivership res or property rights therein do not fall within 28 U.S.C. 125 (now 959) as same would divest the Bankruptcy Court of property in its jurisdiction. This argument has been disputed in Diners Club, Inc. v. Blumb, 421 F.2d 396 (9th Cir. 1970) to



the effect that the test is whether the suit will embarrass the administration of the estate and if it does not, the fact that it affects the res but places only slight burdens on the reorganization court is not determinative if there are other reasons to permit the suit. Additionally, in the instant case there is no res subject to the jurisdiction of the Bankruptcy Court and the Joint Venture has never sought to establish ownership rights in the deed of trust. The Bankruptcy Court opines that it was not part of FMI business to foreclose, which begs the issue whether it was then doing an act in carrying on business connected with the property, and then concludes it was FMI's duty to preserve and protect the debtor's rights, title or interest in the property. Respondents did not interfere with the right of FMI to direct the sale of the property or to require the proceeds secured by the lien to be applied to its debt. Respondents did, under Mississippi law, require the Trustee (though the nominal defendant in the Mississippi Action is FMI the real party in interest was the trustee) to show cause pursuant to Mississippi law why he should not conduct a judicial foreclosure and did thus preclude the trustee from paying over to FMI such portion of the proceeds of the sale (\$75,964.33) as were not secured by the deed of trust and which is the property of the Joint Venture; it appearing the trustee's sale extinguishes the mechanic's and materialmen's lien under Sec. 85-7-105 of the Mississippi Code of 1972 thus



altering the status quo. See: Vass v. Conron Bros. Co., 59 F.2d 969 (2nd Cir. 1932). See discussion under Point IX supra.

In the event it is determined that the authority of FMI to cause the foreclosure of the deed of trust is, as the Bankruptcy Court suggests to be found in Bankruptcy Rule 610 which permits the debtor to prosecute or defend and action before any tribunal (95 ) notwithstanding that the non judicial foreclosure did not involve any action or proceeding before any tribunal, can there be any question that if FMI filed suit against the Joint Venture in Mississippi that the Joint Venture would then have a right to file an answer thereto or to assert any affirmative defense thereto or any compulsory counterclaim it may have without first going to New York to obtain leave of the Bankruptcy Court?

The Bankruptcy Court concluded that Respondents were only attempting to protect a pre-petition indebtedness but failed to note: (1) that the indebtedness of \$75,964.33 was owing from Camellia Bay Corporation to the Joint Venture and (2) that there then existed an executory contract between FMI and the Joint Venture for completion of the project in connection with which FMI holds \$75,964.33 in trust for the benefit of the Joint Venture (111). In Re: Liebig, Petition of Holley, 255 F. 458 (2nd Cir. 1918).



The Mississippi Action (in connection with the foreclosure, as it threatened to cut off the lien rights of the Joint Venture [Sec. 85-7-105 Mississippi Code of 1972] and was conducted at variance with the Mississippi law in that proper notice of the proposed sale was not given pursuant to Section 89-1-55, Mississippi Code of 1972) was properly instituted without consent of the Bankruptcy Court.

City of New York v. Patton, 390 F.Supp. 1001 (S.D.N.Y. 1975) as the actions of FMI giving rise thereto occurred subsequent to the filing of the Chapter XI petition, and the blanket injunction contained in Rule 11-44 cannot be construed to affect Respondents' right to maintain suit under 28 U.S.C. 959, particularly where, as in the instant case, there is no showing or evidence or insufficient evidence that prosecution of the Mississippi Action will embarrass the administration of FMI's estate. Novo Enzyme Corp. v. Baker, 361 F.Supp. 337 (S.D.N.Y. 1973). The Court in Novo Enzyme Co., supra, at page 339 quotes with approval the statement of the Court in Diners Club, Inc. v. Blumb, 421 F.2d 396 (9th Cir. 1970) to the effect that:

"In any event, a blanket injunction issued automatically when the receiver or trustee is appointed is significantly different from an injunction against a particular suit, issued after an independent examination by the reorganization judge. The former involves no exercise of discretion with regard to any specific suit and may properly be regarded as a simple incident of the appointment of the receiver or trustee. Hence it is entitled to no greater weight in subsequent proceedings than the fact of appointment itself."



"We need not decide whether the scope of the discretion of the judge of the reorganization court is especially narrow when there is a question of enjoining a suit permitted by the first section of § 959. See 6 Collier, Bankruptcy ¶ 3.31(2) at 650 (14th Ed. 1969). For, regardless of the effect of § 959(a) there is a strong policy against enjoining suits in other courts except upon a satisfactory showing that prosecution of the action would embarrass the administration of the estate. Foust v. Munson S.S. Lines, 299 U.S. 77, 84, 57 S.Ct. 90, 81 L.Ed. 49 (1936), Thompson v. Texas Mexican Ry., 328 U.S. 134, 140-141, 66 S.Ct. 937, 90 L.Ed. 1132 (1946). No such showing has been made here."

In the instant case neither the Bankruptcy Court nor the District Court has suggested that the Mississippi Action would embarrass the administration of FMI's estate.

Perhaps the Supreme Court of the United States had this very issue in mind as it promulgated Bankruptcy Rule 11-24 in providing that the Bankruptcy Court shall give ten days notice of:

"(2) any proposed sale of property, other than in the ordinary course of business." (emphasis added)

The effect of the Rule is to provide all interested parties with an opportunity to such relief, if any they require, from the Bankruptcy Court in the event of a sale not in the ordinary course of business. But if no such notice is given, and none was given in the instant case, then it appears clear that the sale is taking place in the ordinary course of business and all interested parties have their remedies under 28 U.S.C. 959. On the other hand, if the District Court is correct in its reliance upon American Associated Systems, Inc. supra, and the Bankruptcy Court is correct in relying upon



Bankruptcy Rule 610, then it appears that a tort has been visited upon the Joint Venture by FMI in "furtherance of the bankruptcy business operations "in failing to give notice and consequently the Mississippi Action is within the purview of 28 U.S.C. 959.



XI.

Bankruptcy Rule 11-44 Is Unconstitutional as  
Applied in That It Deprives the Joint Venture,  
At Least Temporarily, Of Its Property  
Without Notice or Hearing

Respondents admittedly are not clear as to the meaning of Rule 11-44 but contend that said rule does not mean that FMI may, in violation of Mississippi law, take possession in Mississippi of property from an Owner indebted to the Joint Venture in the amount of \$75,964.33, to which property the Joint Venture has a superior right at a time when FMI is in default on its obligations that are the basis of its beneficial interest in a deed of trust and then cause the Joint Venture to litigate its right as against FMI in New York. In the event any other construction is sought to be given to Rule 11-44 then in the instant case where the result will be to deprive the Joint Venture of the right, for any period of time, to possession of its property it appears that the rule is unconstitutional in that it provides for temporary loss of possession without prior notice or hearing in connection therewith. Sniadach v. Family Finance Corp., 395 U.S. 337, 89 S.Ct. 1820, 23 L.Ed.2d 349 (1969), Fuentes v. Shevin, 407 U.S. 67, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972), North Ga. Finishing, Inc. v. Di-Chem, Inc., \_\_\_\_\_ U.S. \_\_\_\_\_, 95 S.Ct. 719, \_\_\_\_\_ L.Ed.2d \_\_\_\_\_ (1975). In the instant case, it is crystal clear that even if the argument were advanced that Rule 11-44 should be construed



to be applicable only upon this Court's entry of order authorizing FMI to operate its business rather than upon the mere filing of the petition, still there could not have been even "...a summary determination of relative rights of the disputing parties before stepping into the dispute..."

Fuentes at 80, 92 S.Ct. 1994, because for whatever reason FMI may have had, it elected not to apprise this Court of the existence of the Joint Venture or Respondents until late in the month of March, 1975. Of course, in dicta, Fuentes does indicate that in certain extraordinary situations lack of notice and hearing may not be unconstitutional but one of the requirements therefor is a showing as applied to the Joint Venture of a special need for very prompt action while in the instant case the foreclosure of FMI required a period of three weeks duration and again, the Bankruptcy Court was not apprised of the existence of the Joint Venture or Respondents nor of their claim.

It has long been the rule in bankruptcy that there could be no sale of realty free and clear of other liens and encumbrances without prior notice and opportunity to be heard (FMI represented it was selling the property free and clear; that it had good title) and under Mississippi law the sale was cutting off the mechanic's and materialmen's lien of the Joint Venture, 85-7-105 of the Mississippi Code of 1972. And, of course:



"...civil contempt falls with the order if it turns out to have been erroneously or wrongfully issued." Cliett v. Hammonds, 305 F.2d 565 at 570 (5th Cir. 1962) and Supreme Court cases cited therein.



XII.

The District Court Erred in Predicating Its  
Finding of Contempt Upon Information Obtained  
After the Institution of the Mississippi Action

The Certificate of Facts charges Respondents with violation of Rule 11-44 of the Chapter XI Rules in that Respondents "...commenced the Mississippi Action..."(12) The issue of continued prosecution of the Mississippi Action in addition to the commencement thereof had previously been considered by the Bankruptcy Court as follows:

"THE COURT: That is what I think is the gist of the contempt action, the contempt by action brought for this particular relief, 1,2,3 and 4.

MR. KRASNOW: Yes, your Honor, plus the action taken in connection with the suit by the respondents.

THE COURT: What they did followed in connection with it, but actually the commencement of an action that is stayed by Rule 11-44. Actually the point of the commission of the offense is the institution of an action." (38)

It is clear then that Respondents are only charged with violation of Rule 11-44 by the commencement as opposed to continuation of the Mississippi Action. As the decision of the District Court is predicated upon continuation rather than commencement of the Mississippi Action:

"...he should have ordered the suit discontinued." (21)

it is without the scope of the pleadings.



XIII.

The District Court Erred in Granting Relief  
Because of Conflict of Interest

In the instant case, as no attorney's fee or expense is allowable to Mr. Jim Young or his firm by reason of his conflict of interest, FMI owes no attorney's fees and consequently has no damages. In Re: T.L. Kelly Dry Goods Co., 102 F. 747 (E.D.Wis.1900) In Re: A & B, 209 A.2d 101 (New Jersey 1965). In Re: Waugh, 95 F.2d 451 (7th Cir. 1938) cert. denied, 305 U.S. 610, 59 S.Ct. 69, 83 L.Ed. 388. Rule 215 of the Bankruptcy Rules. Harmar Drive-In Theater v. Warner Bros. Pictures, 239 F.2d 555 (2nd Cir. 1956), rehearing denied, 241 F.2d 937. It will appear to the Respondents remarkable if conduct that should result in suspension of the right to practice law can also give rise to a claim for damages. Richardson v. State, 192 So. 875 (Div. B. Fla. 1940).

The conflict of interest vitiates the entire proceedings with all the greater force as to Respondents since prior to the testimony before the Bankruptcy Judge on April 10, 1975, all Respondents were unaware that their Mississippi counsel, Mr. Tom Crockett (113, 124) was assisting FMI in its foreclosure. (32A)



XIV.

The District Court Has Erred in Finding  
Counsel for The Joint Venture Guilty of Civil Contempt

In the recent case of Maness v. Meyers, \_\_\_\_\_ U.S. \_\_\_\_\_, 95 S.Ct. 584 (1975) involving a criminal contempt, the Supreme Court set aside the holding of counsel in contempt. In its opinion, the Court cites with approval its prior decision in In Re: Watts & Sachs, 190 U.S. 1, 23 S.Ct. 718, 47 L.Ed. 933 (1903). In that case, lawyers advised their clients in good faith that state, not federal courts had bankruptcy jurisdiction over certain property in the hands of a state receiver. In the resultant collision between the state and federal courts, the attorneys were cited for contempt. The Supreme Court held that although the lawyers' advice was substantially incorrect, it would not allow the contempt convictions to stand because there was no evidence the advice was given in bad faith. The Maness case cites a portion of the decision in In Re: Watts & Sachs at page 596 as follows:

"In the ordinary case of advice to clients, if an attorney acts in good faith and in the honest belief that his advice is well founded, and in the just interests of his client, he cannot be held liable for error in judgment. The preservation of the independence of the bar is too vital to the due administration of justice to allow the application of any other general rule."



Of course, it is obvious the client may hold his attorney liable for an error in judgment, but the Court is speaking of other parties. While the instant proceeding is civil, it does appear to be less compelling to hold an attorney individually responsible in a civil proceeding than it does in a criminal contempt proceeding because in the criminal proceeding, the lawyer must necessarily stand accused in essence of interference with the administration of justice, the foundation of our very society, whereas in civil contempt proceedings in essence, the Court only attempts to preserve the rights of a private party. In the concurring opinion of Justice Stewart joined by Justice Blackmun at page 597 of the Maness case, Powell v. Alabama, 287 U.S. 45, 53 S.Ct. 55, 77 L.Ed. 158 is noted as to the due process right to retain counsel in civil proceedings with the following quotation:

"If in any case, civil or criminal, a state or federal court were arbitrarily to refuse to hear a party by counsel, employed by and appearing for him, it reasonably may not be doubted that such a refusal would be a denial of a hearing and therefore, of due process in the constitutional sense."

The concurring opinion goes on to note that it requires no expansion of the aforestated principal to prohibit or punish good faith advice given by retained counsel. Can it seriously be argued that holding counsel severally liable for \$20,701.44 would be less of an impediment to retained counsel's giving good faith advice and acting on behalf of his client than the \$500 fine involved in the Maness case?



Clearly as it is the obligation of an advocate to contend for the rights of his client, he is immune from civil liability. Imbler v. Pachtman, 500 F.2d 1301 (9th Cir. 1974), 44 U.S.L. WEEK 35 (U.S. Mar. 2, 1976)



#### SUMMARY OF ARGUMENT

It does appear that Appellants are not guilty of civil contempt as:

(1) The Bankruptcy Court is without authority to certify for contempt a violation of a rule;

(2) Rule 11-44 is not applicable as the rights of FMI in the deed of trust are not within the jurisdiction of the Bankruptcy Court;

(3) Rule 11-44 is not applicable because the Mississippi Action does not embarrass the estate of FMI or affect its plan;

(4) Rule 11-44 is not applicable as FMI sought to alter the status quo;

(5) Rule 11-44 is not applicable as the Mississippi Action is maintainable under 28 U.S.C. 959;

(6) Respondents did not have knowledge of the FMI Chapter XI proceedings.

In the event the Court should find that on March 24, 1975 the wording of Rule 11-44 could leave no doubt as to its meaning, that Respondents did in fact know of the Chapter XI proceeding prior to the filing of the Mississippi Action and that the Bankruptcy Court had jurisdiction still, if the sum total of the issues raised demonstrates the conduct of Respondents is of doubtful propriety, but that there was no intent to violate an order, punishment for




civil contempt is unwarranted where the actions, as here, prove harmless.

CONCLUSION

For the reasons stated above, Appellants respectfully pray that the decision of the United States District Court for the Southern District of New York adjudging Appellants guilty of civil contempt and directing them to effectuate the turnover of \$75,964.33 be reversed; that Appellants be awarded their costs and attorney's fees and for such further relief as the Court may deem proper.

Respectfully submitted,



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(713) 225-0837



IN THE CIRCUIT COURT OF THE FIRST JUDICIAL DISTRICT  
OF HINDS COUNTY, MISSISSIPPI

FIDELITY MORTGAGE INVESTORS,  
DEBTOR-IN-POSSESSION

PLAINTIFF

VS.

NO. 22,870

CAMELLIA BAY CORPORATION, ET AL

DEFENDANTS

STIPULATION OF FACTS FOR HEARING  
ON MOTION TO DISMISS FOR LACK OF JURISDICTION

There having been filed a Motion to Dismiss for Lack of Jurisdiction on behalf of two of the defendants herein, and in order to facilitate the disposition of said motion, the undersigned parties, by and through their attorneys, hereby stipulate that the following facts are true and correct:

1. Fidelity Mortgage Investors is a Massachusetts Business Trust under Declaration of Trust dated May 29, 1969, as amended and restated and does not hold a certificate of authority to do business in Mississippi.

2. The trustees of Fidelity Mortgage Investors, none of whom is a resident of Mississippi, at all times relevant to this action acted in their capacities as trustees and not as individuals.

3. The principal business offices of Fidelity Mortgage Investors are located in Jacksonville, Florida.

4. At all times relevant to this action, Fidelity Mortgage Investors was the construction lender on a certain condominium project located in Rankin County, Mississippi, adjacent to the Ross Barnett Reservoir.

5. At all times relevant to this action, the owner of said project was Camellia Bay Corporation, a Mississippi corporation domiciled in Jackson, Hinds County, Mississippi.

EXHIBIT "A"



6. At all times relevant to this action, the maker of the note given in consideration of the construction loan and directly and primarily guaranteed by Allen C. Thompson, Jr., Elizabeth B. Thompson, and First General Resources Company was Camellia Bay Corporation, a Mississippi corporation domiciled in Jackson, Hinds County, Mississippi.

7. The construction loan was closed in Jackson, Hinds County, Mississippi, with Eugene C. McRoberts, Jr., a resident of Jackson, Hinds County, Mississippi, serving as attorney and trustee.

8. At the time the construction loan was closed, Allen C. Thompson, Jr. was an officer and director of the Camellia Bay Corporation, a Mississippi corporation domiciled in Jackson, Hinds County, Mississippi.

9. The construction work on said project was performed by Farnale, Inc., a Texas corporation, holding a certificate of authority to do business in Mississippi and by Camellia Builders, Inc., a Mississippi corporation, both acting as a joint venture.

Respectfully submitted,

ALLEN C. THOMPSON, JR. AND  
ELIZABETH B. THOMPSON

BY: 

T. H. Freeland, III  
Their Attorney

FIDELITY MORTGAGE INVESTORS

BY: 

E. Stephen Williams  
Its Attorney